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No. 76-1402

In the Supreme Court of the United States

OCTOBER TERM, 1976

POIRIER & McLANE CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. McCREE, JR.,
Solicitor General,
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The question presented in this federal income tax case is whether the court of appeals correctly held that petitioner was not entitled to a deduction under Section 461(f) of the Internal Revenue Code of 1954 (26 U.S.C.) for amounts transferred into trust by it in 1964.

Section 461(f) of the Code provides that if a taxpayer transfers money or other property to provide for the satisfaction of a contested liability, and if, but for the fact that the liability is contested, a deduction would otherwise be allowed for the taxable year of the transfer or an earlier taxable year, then the deduction shall be allowed for the taxable year of transfer. The Treasury Regulations require that such a transfer, if made to a trust, be pursuant to a written agreement among the trustee, the taxpayer and the person who is asserting the claim. Treasury

Regulations on Income Tax, Section 1.461-2(c)(1)(ii) (26 C.F.R.). In this instance, petitioner transferred into a trust without the knowledge, much less the signed agreement, of certain claimants, funds that could be used to discharge its liability if it were ultimately held liable to the claimants. The court of appeals therefore held that the transfer did not qualify for deduction under the statute or regulations (Pet. App. 2a-3a).

The pertinent facts are as follows: Petitioner was an accrual-basis taxpayer engaged in construction work. As a result of work it performed, as general contractor for the construction of public subway and parkway facilities, various claimants brought tort damage actions totaling more than $14 million against petitioner in the early 1960's. On December 31, 1964, while these actions were still pending, petitioner entered into a trust agreement with Manufacturers Hanover Trust Company (the trustee), under which petitioner transferred $1 million in trust to the trustee. None of the claimants was a party to the trust agreement (Pet. App. 3a-4a).

The agreement provided that the trust fund was to be held by the trustee for the sole purpose of paying petitioner's obligations that might arise from the litigation against petitioner; the balance remaining after the disposition of the claims was to be returned to petitioner upon its statement that the claims had been determined and resolved. In 1969, one of the claimants prevailed to the extent of $11,600. In late 1969, petitioner notified the trustee that all of the claims had been disposed of, and the trustee returned the entire trust corpus to petitioner[1] (Pet. App. 3a-4a).

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[1]Nothwithstanding petitioner's notification to the trustee that all claims had been resolved, the Appellate Division of the New York Supreme Court subsequently increased the damages awarded on the one claim to $14,200 and reversed a judgment of the New York Court of Claims that had dismissed a second claim for lack of jurisdiction. *Bronxville Palmer* v. *State of New York*, 36 App. Div. 2d 10, 318 N.Y.S. 2d 57, modified, 30 N.Y. 2d 760, 284 N.E. 2d 577; *Bronxville Palmer* v. *State of New York*, 36 App. Div. 2d 647, 318 N.Y.S. 2d 412. While the record does not reveal the ultimate outcome of the second claim neither claim had been disposed of at the time the trustee returned the trust corpus to petitioner.

On audit, the Commissioner of Internal Revenue disallowed petitioner's claimed deduction on its 1964 income tax return of the $1,100,000 transferred to the trustee (Pet. App. 4a-5a). In a reviewed decision, with four dissents, the Tax Court upheld petitioner's claimed deduction (Pet. App. 22a-43a). The court of appeals, with one dissent, reversed (Pet. App. 1a-21a).

The court of appeals, in a decision that petitioner acknowledges (Pet. 7) to be one of first impression, correctly held that petitioner was not entitled to a deduction under Section 461(f) for its 1964 payment to the trust. Section 461(f) was enacted to modify this Court's decision in *United States* v. *Consolidated Edison Co.*, 366 U.S. 380, which held that the proper year for an accrual-basis taxpayer to deduct a contested property tax was the year in which the contest was terminated rather than the earlier year in which the taxpayer paid the tax under protest. However, the legislative history shows that Congress intended to allow a current deduction for funds paid by a taxpayer to satisfy a contested, but otherwise deductible, liability only if the payment was made to someone beyond the taxpayer's control, either directly to the person asserting the liability or to an escrow agent. Compare S. Rep. No. 830, 88th Cong., 2d Sess. 100 (1964), with S. Rep. No. 830, 88th Cong., 2d Sess. 243 (1964).

As the court of appeals observed, the requirement of Section 1.461-2(c)(1)(ii) of the Treasury Regulations that the persons asserting the liability consent in writing to

the creation of the trust prevents potential abuse and is "an integral means of effectuating the legislative intent" (Pet. App. 13a). However, petitioner contends that the claimants were parties to the trust agreement because they were the intended beneficiaries, even though they were unaware of its existence. But such a construction is at odds with the language of the Regulation, which must be sustained unless unreasonable or plainly inconsistent with the statute. *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501. If the Commissioner had intended to qualify a trust arrangement without the knowledge or consent of the claimant, the Regulation would not have even mentioned the claimant, much less required a written agreement "among" the taxpayer, trustee, and the claimant.[2]

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[2]The decision below is further supported by settled principles of trust law. A trust for payment of creditors, created without the creditors' express agreement, is presumed to be for the benefit of the grantor, who may revoke the trust at any time. See 2 ALI, *Restatement (Second) of Trusts*, § 330, Comment h (1959). Compare IV Scott on *Trusts*, § 330.6 (3d ed. (1967)), and *Ehag Eisen. Holding AG.* v. *Banca Nat. a Romaniei*, 306 N.Y. 242, 251-252, 117 N.E. 2d 346, 351, with *Berlenbach* v. *Chemical Bank & Trust Co.*, 235 App. Div. 170, 256 N.Y.S. 563, motion for leave to appeal denied, 235 App. Div. 791, 256 N.Y.S. 946, affirmed, 260 N.Y. 539, 184 N.E. 83. Accordingly, the transfer here by petitioner into the trust was not made to someone beyond petitioner's control as Congress required. Petitioner errs in stating (Pet. 7) that the court of appeals relied upon the *Ehag Eisen* case. To the contrary, the case was mentioned only in a footnote (Pet. App. 12a) in which the court expressly disavowed any reliance on the "intricacies of the trust law" and found instead that "the source of this Regulation lies in the legislative history of § 461(f)."

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.,
Solicitor General.

JUNE 1977.